



APPENDIX

Revenue Act of 1938, c 289, 52 Stat. 447:

SEC. 22. GROSS INCOME

(a) General Definition.—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . .

Reg. 111, as added by T. D. 5488, Dec. 29, 1945:

Sec. 29.22(a)-21. TRUST INCOME TAXABLE TO THE GRANTOR AS SUBSTANTIAL OWNER THEREOF.—(a) *Introduction*.—Income of a trust is taxable to the grantor under section 22 (a) although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. (*Helvering v. Clifford*, 309 U. S. 331). In the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and

diversified factual situations has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under section 22(a). Such factors are set forth in general in subsection (b) and in detail in subsections (c), (d), and (e), below.

(b) *In general.*—In conformity with the principle stated in subsection (a) above, the income of a trust is attributable to the grantor (except where such income is taxable to the grantor's spouse or former spouse under section 22(k) or 171) if—

(1) the corpus or the income therefrom will or may return after a relatively short term of years (see subsection (c))

(2) the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (other than certain excepted powers), whether by revocation, alteration, or otherwise, exercisably by the grantor, or another person lacking a substantial adverse interest in such disposition, or both (see subsection (d)); or

(3) the corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor (see subsection (e))

(c) *Reversionary interest after a relatively short term.*—Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment—

(1) within 10 years commencing with the date

of transfer, or

(2) within 15 years commencing with the date of the transfer if the income is or may be payable to a beneficiary other than a donee described in section (23) (c) and if any one or more of the following powers of administration over the trust corpus or income are exercisable solely by the grantor, or spouse living with the grantor, or both, whether or not exercisable as trustee; a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property, whether or not of an equivalent value.

Where the grantor's reversionary interest is to take effect in possession or enjoyment by reason of some event other than the expiration of a specific term of years, the trust income is nevertheless attributable to him if such event is the practical equivalent of the expiration of a period less than or equal to 10 or 15 years, as the case may be. For example, a grantor is taxable on the income of a trust if—

(A) the corpus is to return to him or his estate on the death of a person whose life expectancy is six years at the date of the transfer in trust; or

(B) the corpus is to return to him or his estate on the graduation from college or prior death of his son, who is 18 years of age at the date of the transfer in trust.

In general, a reversionary interest may reasonably be expected to take effect in possession or enjoyment within 10 or 15 years, as the case may be, where the

corpus or the income therefrom is to be reacquired if the grantor survives any stated contingency which is of an insubstantial character. Thus, the grantor is taxable where the trust income is to be paid to the grantor's wife for three years, and the corpus is then to be returned to the grantor if he survives such period, or to be paid to the grantor's wife if he is already deceased.

Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement.

Example. A places property in trust for the benefit of his son B. Upon the expiration of 12 years or the earlier death of B the property is to be paid over to A or his estate. Neither A nor his wife has any power of administration over the trust corpus or income. After the expiration of nine years A extends the term of the trust for an additional two years. A is considered to have made a new transfer in trust for a term of five years. He is not taxable on the income for the first three years of such term because he would not be taxable thereon if the term of the trust had not been extended. A is taxable, however, on the income for the remaining two years.

(d) *Power to determine or control beneficial enjoyment of income or corpus.*—Income of a trust is taxable to the grantor where, whatever the duration of the trust, the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition

(except as provided in section 167(c) and as hereafter provided in exceptions (1) to (5), inclusive), whether by revocation, alteration, or otherwise, exercisable (in any capacity and regardless of whether such exercise is subject to a precedent giving of notice or is limited to some future date) by the grantor, or any person not having a substantial adverse interest in the beneficial enjoyment of the corpus or income, whichever is subject to the power, or both. The grantor is not taxable, however, if the power, whether exercisable with respect to corpus or income, may only affect the beneficial enjoyment of the income for a period commencing more than 10 years from the date of the transfer (or 15 years where any power of administration specified in subsection (c) is exercisable solely by the grantor, or spouse living with the grantor, or both, whether or not as trustee). For example, if a trust created on January 1, 1940, provides for the payment of income to the grantor's wife, and the grantor does not reserve any such administrative power but reserves the power to substitute other beneficiaries in lieu of his wife on or after January 1, 1950, the grantor is not taxable on the trust income for the period prior to January 1, 1950. But the income will be attributable to the grantor for the period beginning on such date unless the power is relinquished. If the beginning of such period is postponed, such postponement is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement. Where the income

affected by the power is for a period beginning by reason of some event other than the expiration of a specific term of years, the grantor will be taxable if such event is the practical equivalent of the expiration of a period less than or equal to 10 or 15 years, as the case may be, in accordance with the criteria stated in subsection (c).

This subsection shall not apply to any one or more of the following excepted powers:

(1) a power exercisable only by will, other than a power in the grantor to appoint the income of the trust where the income is accumulated for such disposition by the grantor, or may be so accumulated in the discretion of the grantor, or any person not having a substantial adverse interest in the disposition of such income, or both. For example, if a trust provides that the income is to be accumulated during the grantor's life and that the grantor may appoint the accumulated income by will, the grantor is taxable on the trust income;

(2) a power to determine the beneficial enjoyment of the corpus or the income therefrom if such corpus or income, as the case may be, is irrevocably payable for the purposes and in the manner specified in section 23 (o);

(3) a power which merely enables the grantor or another person to distribute or apply income to or for a current income beneficiary or to accumulate such income for him, provided that any accumulated income must ultimately be payable to the beneficiary from whom distribution or application is withheld, or, if payable upon the complete termination of the trust or in conjunction with a distribution of corpus which distribution is

augmented by such accumulated income, is ultimately payable to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument. Accumulated income shall be considered so payable although it is provided that if any beneficiary does not survive the date of distribution, the share of such deceased beneficiary is to be paid to a designated alternate taker, other than the grantor or his estate, if such date may reasonably be expected to occur within the beneficiary's lifetime, and if the share of such alternate taker has been irrevocably specified in the trust instrument;

(4) a power which merely enables the grantor or another person to pay out corpus to or for a current income beneficiary, provided that any such payment of corpus must be chargeable against the proportionate share of corpus held in trust for the payment of income to such beneficiary as if such corpus constituted a separate trust, or provided that the power is limited by some reasonably definite external standard. For the requirements of such standard, see exception (5);

(5) a power to apportion income (whether by distribution or accumulation) to or within a class of beneficiaries if such power is exercisable exclusively by a trustee other than the grantor or spouse living with the grantor and its exercise is not subject to the approval or consent of any person other than such trustee and is limited by some reasonably definite external standard. Such standard must be set forth in the trust instrument, must consist of the needs and circumstances of the beneficiaries within the class, and must be susceptible of enforcement by

a court of equity. For example, a provision authorizing the payment of income to members of a class in such amounts as the trustee shall determine wise and proper in the exercise of his honest discretion, or in such amounts as the trustee determines to be in the best interests of the beneficiaries, does not meet the requirements of the external standard contemplated by this exception. Nor does a power to appoint within a class of beneficiaries fall within this exception if the trustee is enabled to add to or eliminate from the class of beneficiaries designated to receive the income except in so far as provision may be made for after-born children.

The application of this exception may be illustrated by the following examples, in which it is assumed that the trustee is neither the grantor nor his wife:

Example (1). A transfers property to X as trustee to pay the income in equal shares to B, C, and D, the grantor's three sisters. In any year, however, X may distribute to any one sister an amount not to exceed 60 per cent of the income for that year, provided that the needs of such sister in the particular year, due to illness or poor financial circumstances, are proportionately greater than those of the other sisters. The income of the trust is not taxable to the grantor by reason of such limited power in the trustee. Such income, however, would be taxable if the exercise by X of his power of distribution were not dependent upon the needs of the sisters.

Example (2). A transfers property to X as trustee to pay A's wife such part of the income as X may consider wise and proper for the comfort and happiness of the wife and to pay the balance of the income

to A's son. The income is taxable to the grantor since the power to apportion income is not limited by any reasonably definite external standard.

A mere power to allocate receipts as between corpus and income, even though expressed in broad language, is not deemed a power over beneficial enjoyment with respect to income or corpus.

(e) *Administrative control.*—Income of a trust, whatever its duration, is taxable to the grantor where, under the terms of the trust or the circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. Administrative control is exercisable primarily for the benefit of the grantor where—

(1) a power exercisable by the grantor, or any person lacking a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor or any person to purchase, exchange, or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate and full consideration in money or money's worth; or

(2) a power exercisable by the grantor, or spouse living with the grantor, or both, whether or not in the capacity of trustee, or exercisable by any other person in a nonfiduciary capacity, or by such person and either of the foregoing, or both, enables the grantor to borrow such corpus or income, directly or indirectly, whether with or without adequate security or interest; or

(3) a power exercisable in a fiduciary capacity by a person other than the grantor or spouse living with the grantor enables the grantor to borrow such

corpus or income, directly or indirectly, and such power has been exercised and the grantor has not completely repaid the loan, including any interest, before the beginning of the taxable year; or

(4) any one of the following powers of administration over the trust corpus or income is exercisable by any person in a nonfiduciary capacity: a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property, whether or not of an equivalent value.

If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Such presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries. If a power is not exercisable by a person as trustee, it is presumed that the power is exercisable in a nonfiduciary capacity. But such presumption may be rebutted if it appears, from all the terms of the trust and the circumstances surrounding its creation and administration, that the power is exercisable primarily in the interests of the beneficiaries.

The mere fact that a power exercisable by the trustee is described in broad language does not indicate that the trustee is authorized to purchase, exchange, or otherwise deal with or dispose of the trust property or income for less than an adequate and full consideration in money or money's worth. On the other hand, such authority may be indicated by the

actual administration of the trust.

(f) *Limitations of section.*—Despite the limitations of this section, the grantor of a trust directing the payment or application of the income therefrom in satisfaction of the grantor's legal obligations shall continue to be taxable on the income. The grantor may also be taxable on the income of a trust on the ground that such income is attributable to him in a capacity unrelated to dominion and control over the trust as such as defined in subsections (c), (d), and (e) of this section. Thus, the provisions of this section do not affect the principles governing the taxability of future income to the assignor thereof whether or not the assignment is by means of a trust. Nor, for example, do the provisions of this section affect the applicability of section 22(a) to the creator of a family partnership. See further sections 166 and 167.

Section 22(a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to this section.